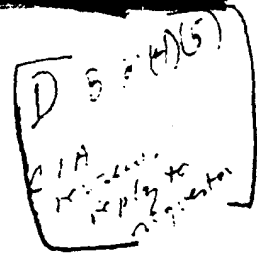




Directorate of Intelligence
23 October 1991

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Special Analysis
Memorandum #16

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The Economic Impact of Deep Cuts in Weapons Production in Russia and Ukraine

This memorandum is part of a special series designed to provide continuing analysis and refinement of previous judgments on the dramatically shifting Soviet scene.

Summary

Recent statements by senior republic leaders--particularly those of Russia and Ukraine--suggest that there is support among some of the leadership to completely halt weapons production for a three-year period. Even if--as is likely--reduction is not halted outright, economic deterioration and force reductions promise substantial production cuts--certainly well over 50 percent for at least several years. Such cuts would encourage potential foreign governmental creditors that their investments would not be used for militaristic purposes, and would free up substantial quantities of materials and components for civil use. Sharp cutbacks also would create turmoil, probably massive unemployment, and loss of hard currency export earnings. Moreover, slow progress in creating market-based economic systems in the republics could lengthen and deepen the transitional problems. Dramatic weapon production cuts and corresponding plant conversion would make it extremely difficult to reestablish current weapon production capabilities over the next decade. ()

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The Proposed Standdown

- ° Several republic leaders have recently raised the idea of a complete halt to weapons production over the next three years as a means of facilitating economic recovery and defense conversion. Russian Vice President Aleksandr Rutskoy, in charge of Russian defense industry conversion, announced in mid-September that he had proposed halting weapons production for three years. Earlier in the month, the USSR deputy minister of defense industry said that the Committee for Management of the National Economy was considering halting all weapons production. These claims were echoed most recently by Russian Deputy Minister of Defense Vitaly Shlykov, Defense Ministry official responsible for conversion in Russia, who claimed at a recent conference in Washington DC that a complete halt to weapons production—including for exports—was part of his own plan for which he had a great deal of support. Shlykov added that he was hoping to get the Russian Supreme Soviet to vote positively on it in the near future. During the three year halt, a large number of weapons plants would be retooled and converted to civil production. All of these men suggested that the state would continue to pay the wages of defense industrial workers during the halt in military production.

During a meeting with French President Mitterand in early October, Ukrainian President Leonid Kravchuk also declared himself in favor a complete halt to weapons production in Ukraine, which contains roughly 15 percent of Soviet defense industry. Kravchuk's thinking on this issue appears less developed than that of his Russian counterparts, however; the previous week, while visiting shipbuilders in Nikolayev, he spoke of the need to assure them supplies and allow them to continue building naval vessels. Nevertheless, statements by Ukrainian Minister on Questions of the Defense Complex and Conversion V. I. Antonov support the idea that Ukraine is contemplating radical cuts and possibly cessation of all weapons production in the near future.

Russian and Ukrainian views on defense cuts are important, because the defense industrial base of the former USSR is largely concentrated in these two republics, with roughly 70 percent of defense industrial enterprises in Russia and 15 percent in Ukraine (see map). The concentration of major final assembly facilities in these republics is even higher. Should they adopt a moratorium on production, the implications for the Soviet economy are

essentially dramatic. This memorandum briefly explores some of these implications. [REDACTED]

Impact on the Soviet Economy

Cessation of weapons production would free up substantial resources to the civil economy. Through years of extensive investment, the Soviets have developed an immense defense industrial base of about 150 major defense plants, and thousands of component and material production facilities. [REDACTED]

Whether this flood of released resources would have a proportionately beneficial effect depends on how well the economy is prepared to absorb them. [REDACTED]

The Potential Pluses...

One of the greatest impacts that a halt in weapons production would achieve--and probably one of the main intentions of those proposing it--would be the final destruction of the priority for defense industry so firmly ingrained in the Soviet economy. In the past, the entire economic system--the planning process, the protective bureaucracy, and the weapons acquisition and funding system--has shielded resources devoted to the military from diversion to other uses. Changes over the past few years have wiped away most of these, but many weapons production programs continue, in part due to inertia: lacking new central guidance, entrenched bureaucrats throughout the system have continued to try to shield defense production from the worst ravages of the Soviet economy. A complete halt to weapons production would finally erase the priority of the defense industries to skilled labor, materials and components, and plant and equipment, greatly diminish the defense-industrialists as a constraint on [REDACTED]

economic reform, and give civil industry a level playing field from which to start. ()

A complete halt in weapons production would affect millions of people directly and potentially free up a vast quantity of many of the resources currently in insufficient supply in the Soviet economy. These resources are transferable to civil uses, however, to different extents:

- o Most materials used in the production of weapons--specialty steels, construction materials, and engineering fibers, for example--are transferable and most are readily transferable (see table). Many of these resources--such as specialty steel--are in great demand in the civilian sector.
- o Many of the components and other intermediate products--such as bearings, composites, and, most importantly, microelectronics--are also fairly easily transferred from military to civilian production, although in many cases intermediate goods used in defense industry are built to specifications that exceed the requirements of civil applications--a factor that boosts costs considerably. Many of these products are badly needed in civilian production. In other cases, however, intermediate goods used in weapons systems are special purpose, and because of their nonstandard design, either cannot be used in civilian products at all or could only be used if the products were redesigned.
- o Freed-up defense industrial labor, particularly highly skilled workers, could also provide a needed boost to civil industry over the long run. In the short run, such transitions are difficult due to the limited geographic mobility of the workforce. Most importantly, it is concentrated in Russia, where demographic trends have augured poorly for the future workforce.
- o The freeing up of defense plant space and equipment, if sufficient funds for conversion are found, could provide the nucleus for future growth in civilian production. Such conversion will be more time-consuming and expensive than the Soviets had originally envisaged, however, and it would be several years before substantial civil payoff would be realized.

The sudden availability of many of these human and material resources could encourage many latent entrepreneurs who have been discouraged by the difficulty of operating in the resource-restricted Soviet economy to come forth. Republic governments could use as much as two-thirds of the savings from the procurement halt to reduce the large budget deficit or subsidize conversion--even if all defense industrial workers continued to be paid, as

Transferability of Selected goods to Civilian Industry

High Moderate Low	Availability from defense industry	Need in civil economy	Transferability
Materials			
Energy	M	H	H
Chemicals	M	H	H
Fibers	M	H	M
Microelectronics materials	M	H	H
Specialty steel	H	H	H
Aluminum	H	H	H
Titanium	H	L	L
Construction materials	M	H	H
Nuclear materials	H	L	L
Intermediate products			
Electric motors	M	H	M
Bearings	M	M	M
Plastics	L	H	M
Microelectronics components	M	H	M
Motor vehicles	H	M	H

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governments have promised. A moratorium on weapons production would allow governments to divert currency away from purchases of Western machinery and equipment for military production in favor of civil applications.

And the Potential Minuses...

The Soviet and republic economic systems—bureaucratic structures, laws and regulations, and even ideological underpinnings—are in flux, and market relations are only beginning. Property rights are undeveloped, and there is still not a well-functioning price system. Under the current unsettled conditions, many of the resources released from the defense sector will be used inefficiently or could lead to the rise of monopolies and organized crime. The Soviet system has traditionally thrown resources unsuccessfully at problems, and without clearer and more constructive policies on prices and private property, it is unlikely to meet with greater success now.

A halt or dramatic cut in production plus the conversion and consolidation of defense industry plants would clearly degrade Soviet defense production capacity and capability as equipment was sold off, workers lost, and component chains destroyed. Such a policy would also seriously diminish industrial mobilization capability; how much will depend on the extent defense industry is downsized and converted. Although Russia and Ukraine have not proposed a corresponding halt in military R&D, overall defense spending cuts and a halt in production would certainly heavily impact on R&D, as Soviet military researchers and designers lose profitable outlets for their work and must seek more lucrative ventures.

The largest impact of a halt in weapons production would be the layoff of defense industrial workers from failing defense plants. Defense enterprises have already been struggling with the challenge of undertaking a major capital investment program to retool and build new plant capacity for civil goods at a time when income from their main products is declining sharply as a result of decreased military orders. This financial bind—as well as the loss of the perquisites and prestige that have accompanied weapons production—has caused defense industry to lose highly skilled workers.

The halt would have a particularly severe impact on selected geographic areas where defense industry is highly concentrated. Within Russia, three major centers—Moscow, St. Petersburg, and the Urals region—have the greatest number of defense-industrial facilities. According to Soviet press

...s, one-fourth of the workers in Moscow and 40 to 50 percent of the workers in St. Petersburg industrial enterprises and R&D institutes work for defense. In some cities of the Urals the proportion is even higher and in some cases, such as the shipyard in Severodvinsk, a single major defense enterprise is the city's predominant employer. Although some leaders have proposed continuing wages for defense industry workers during the period of transition, they would clearly have a difficult time finding the funds to do so. Interfax recently reported that St. Petersburg, for example, expects to lose up to 500,000 jobs—about one-fifth of its workforce—because of cuts in the defense industry over the coming year, and that the city is trying to provide a total of 30 million rubles—roughly 60 rubles per worker—for retraining. Moscow is trying a different approach: Moscow radio reports that Deputy Mayor Yuriy Luzhkov cited potential layoffs of 400,000 to 500,000 of the city's two million defense workers, and proposed using 500 million rubles of the city's budget for civilian orders to help keep them employed. In many of these cities defense industry plants provide housing, schools, and other social services—support that would likely disappear in the event of a halt, thus intensifying the impact on the local economy.

Even the average Soviet citizen is likely to experience fallout from a halt. A complete halt in weapons production would deprive the Soviets of significant hard currency earnings.

Although some of these earnings have been pumped back into the sector for purchase of Western production equipment, much of it in recent years has been devoted to purchasing civilian goods from abroad. Moreover, defense-industrial enterprise closings and bankruptcies may also affect the civil goods produced in that sector—which currently supplies a large proportion of many consumer appliances and other civil products.

Outlook

Given the turmoil that would ensue from a complete halt in production, the potential reaction of the military, and the loss of desperately needed hard currency, it is unlikely that either Russia or Ukraine will opt for complete cessation. Both, however, are likely to implement further substantial cuts—certainly well over 50 percent for at least several years—and to seek outside help for conversion and consolidation of their defense industries.

If the Russians and Ukrainians really were to completely halt weapons production on their territory, they would face an enormous management challenge to ensure that the massive resources freed were not wasted and that large-scale unemployment did not bring chaos. On the one hand, a massive dose of freed resources could allow those with entrepreneurial spirit

to boom to maneuver and potentially succeed in creating new civil industries out of whole cloth. On the other, a populace terrified of impending chaos, combined with the potential for monopolies and organized crime, would make it very difficult for a government to stand idly by and watch the situation develop without instituting the firm control that would be critical to the development of a free market economy.

Major Soviet Defense Industrial Plants

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